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## **SOUTH DAKOTA PUBLIC UTILITIES COMMISSION**

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October 10, 2008

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Re: In the Matter of the Petitions of McCook Cooperative Telephone Company, Beresford Municipal Telephone Company, Kennebec Telephone Company, Santel Communications Cooperative, Inc. and West River Cooperative Telephone Company for Arbitration pursuant to the Telecommunications Act of 1996 to Resolve Issues Relating to Interconnection Agreements with Alltel Communications, Inc. Dockets TC07-112 through TC07-116

Dear Counsel:

Enclosed you will find a copy of Staff's Brief with reference to the above captioned matter. This is intended as service upon you by mail.

Very truly yours,

/S/ ROGER L. OLDENKAMP  
Roger L. Oldenkamp  
Consultant

Enc.

# BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE PETITIONS OF )	STAFF'S BRIEF
MCCOOK COOPERATIVE TELEPHONE )	
COMPANY, BERESFORD MUNICIPAL )	TC07-112
TELEPHONE COMPANY, KENNEBEC )	TC07-113
TELEPHONE COMPANY, SANTEL )	TC07-114
COMMUNICATIONS COOPERATIVE, INC. )	TC07-115
AND WEST RIVER COOPERATIVE )	TC07-116
TELEPHONE COMPANY FOR ARBITRATION )	
PURSUANT TO THE TELECOMMUNICATIONS )	
ACT OF 1996 TO RESOLVE ISSUES )	
RELATING TO INTERCONNECTION )	
AGREEMENTS WITH ALLTEL )	
COMMUNICATIONS, INC. )	

The above-referenced dockets were consolidated for arbitration before the South Dakota Public Utilities Commission and heard before the Commission en banc on July 29 through July 31, 2008. The following issues remain to be resolved by the Commission, there being settlements of other issues separately by the various parties:

Issue #1: Is the reciprocal compensation rate for IntraMTA Traffic proposed by West River, et al., appropriate pursuant to 47 U.S.C. Section 252(d)(2)?

Issue #2: What is the appropriate Percent InterMTA Use factor to be applied to non-IntraMTA traffic exchanged between the parties?

Issue #3: What is the appropriate manner by which the minutes of use of IntraMTA Traffic terminated by the parties, one to the other, should be calculated and billed?

Issue #6: What is the appropriate definition of IntraMTA and InterMTA traffic?

## Staff General Comments

Staff's position is that this case falls within the legal purview of *Ace Telephone Ass'n, et al. v. Koppendray, et al.* (432 F.3d 876). This U.S. Court of Appeals case from the Eighth Circuit stands for the proposition that the decision(s) of a state Public Utility Commission in a Telecommunication Arbitration case shall be binding on the parties unless the Commission acts arbitrarily and capriciously. Staff believes that given the evidence in this case, the Commission has wide latitude in arriving at an arbitrated decision with regard to the issues in this case. Staff submits that the Commission should exercise that latitude by making a finding that is consistent with the applicable laws, recognizing that the statutory direction given is somewhat vague and ambiguous; and analyzing the facts and representations as presented by the parties in light of serving the best interest of the South Dakota public. Staff does not believe that any other court cases cited by the parties or researched by Staff are definitive or controlling of the issues in the matter.

In Staff's opinion, the heart of these issues is not legal, but economic in the sense that economic reasoning must be applied to resolve the issues given the statutory direction provided.

Staff desires a result that is not only consistent with statutory direction, but consistent with economic theory and practice. The long-term efficiency and financial viability of telecommunication carriers in the state is of paramount concern. Efficiency dictates that pricing signals should be set to maximize future technological efficiency shifts. Viability dictates that pricing signals should fairly allow the parties to be adequately compensated.

Staff further suggests that the Commission grant finality to this process by making its ruling(s) effective for the full-term of the anticipated relationship between the parties. The evidence in this matter is hardly clear, nor could it likely be classified under any definition, as the best available evidence. Staff is of the opinion that it was produced in good faith by the parties and would submit that a final decision can be made with the testimony at hand.

Staff takes no position on issues pertaining to the admissibility of evidence or testimony taken under advisement by the Commission, if any.

As a practical matter, Staff has elected to comment on Issue #6 first. The issue of definition may/could influence the position Staff would take on the other issues.

#### Issue #6

The global definition of InterMTA traffic is, in Staff's opinion, a relatively simple one, agreed to in part, by the parties (e.g. "InterMTA traffic is all traffic which originates in one MTA and terminates in another MTA. IntraMTA traffic is all traffic which originates and terminates in the same MTA"). Staff believes that the practical, working definition of InterMTA and IntraMTA traffic should additionally encompass those features of the global definition which are most effectively measured. The measurement issue is determinative in Staff's opinion. Petitioners have presented credible evidence that current practices make the precise measurement of this traffic impractical. Therefore, the additional definition language proposed by the Petitioners is a fair measure when viewed over the course of the proposed agreement in that it adds a measure of clarity to the ultimate practice of measuring this traffic. It has been approved by the FCC (c.f. "Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98" and "Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers", CC Docket No. 95-185, First Report and Order, FCC 96-325, Released August 8, 1996, at para. 1044 ("First Report and Order") and Staff recommends that it be adopted. Staff does not believe that Alltel has offered enough evidence to prove that these additions to the global definition would not improve the ongoing relationship with the Petitioners.

Staff recommends that the additional language proposed by the Petitioners be adopted into the Agreement by the Commission.

#### Issue #1

A statutory framework for determining reciprocal compensation rates for IntraMTA traffic has been set forth in the Federal Telecommunications Law (1996). The application of the TELRIC standard (total element long-run incremental cost) to the historic costs (FLEC studies) is at issue here. In economic terms, Staff would characterize Alltel's position as allowing for short-run marginal cost pricing only. Short-run marginal costs (usage sensitive costs) would be defined to be those additional future costs that would be incurred by the Petitioners in order to process one additional minute of connection time. In the very short term, that would be zero or a close approximation of zero (c.f. the \$.001/minute rate suggested by Alltel). The Minnesota PUC used this type of reasoning in setting reciprocal compensation rates at zero. Further the U.S. Eighth Circuit held that

this finding was not arbitrary or capricious. Adopting this reasoning is the safest way to handle this issue. Staff does not believe it is the best, but it is the safest.

From an economic theory perspective, the distinction between short-run and long-run marginal costs is very significant. In the extreme short run, marginal costs in a highly capitalized industry are virtually zero. In the extreme long run, where all costs are fully variable with output, marginal costs approach the full cost of providing the service (c.f. *Shaping American Telecommunications - A History of Technology, Policy and Economics* by Sterling, Berndt and Weiss, Routledge Publishing, 2005). Staff has two reasons for supporting the argument that the spirit of the law supports a long-run view. The first reason involves the inclusion of the term 'long run' specifically in the TELRIC standard. In the long-run, where all resources are variable, being subject to the efficient use exit or the entrance of a different, more efficient resource mix. The current equipment configuration the Petitioners are using at the moment, whether or not it meets current capacity or not, is not relevant in the long-run. Forward looking, long-run costs can only be estimated, but reconfiguration would be more likely under an efficiency requirement. The forward cost of reconfigurations of Petitioners' equipment has been fairly accounted for in their study and testimony.

The second reason Staff supports a long-run incremental/marginal cost pricing structure involves fairness. Using short-run marginal cost theory as proposed by Alltel places the overwhelming burden of present and future cost on the Petitioners with a significant 'free rider' effect available to Alltel. In addition to the significant efficient reconfiguration costs, the cost of incremental future capital contributions is specifically included in TELRIC. A significant source of incremental future capital contributions is firm retained earnings. This is particularly true in forward situations involving capital credit market impairment, like the current U.S. capital credit market. Profit margin contributions to retained earnings may likely be the dominant source of the Petitioners' forward-looking cost of capital situation. Neither Petitioners nor staff are suggesting that Alltel pay the estimated long-run average total cost per minute for connection services (note: this would be the true, long-run marginal cost for a firm operating in perfect competition. The model of perfect competition being used in TELRIC). Staff is suggesting that Alltel pay an amount that reflects the necessary incremental profit and operating margin to allow Petitioners to acquire forward-looking capital and place themselves in a position to reinvest in the future of rural South Dakota telecommunications.

Determining exactly what such a reciprocal compensation rate should be given the studies and evidence produced in this record is an extremely difficult task. The studies are older than preferred. The very nature of cost studies is inherently subjective and it doesn't add to the credibility of the studies when the cost results vary unsystematically at a significant level from firm to firm. The local traffic reciprocal compensation rates per minute of use proposed by each Petitioner are a fair, while not likely an accurate, representation of rates that comply with the TELRIC standard. They appear from the record to be significantly less than long-run average total costs per minute. Staff recommends that the Petitioners' reciprocal compensation rates for IntraMTA traffic be adopted.

## Issue #2

The establishment of an appropriate InterMTA Use factor is also an imperfect estimation process according to the testimony from both sides in this matter. Various methods have been employed to make these estimations, e.g. POI, CDR, SS7, etc. FCC Rules are of little assistance in determining how these factors are to be developed, nor have court cases validated one method over all others. It seems that all methods are somewhat methodologically flawed. Petitioners have performed a traffic study and offer it as a template for the resolution of this issue. The traffic study

is not current and could have been updated and done taking into consideration different factors, in other words, it is far from perfect. That being said, given Alltel's position that they believe these are best 'negotiated' by and between the parties, the study is all Staff has to go on. Staff does support Alltel's contention that 'negotiation' of these factors is the most appropriate way to resolve this issue. Unfortunately, that is of little value when negotiations fail and the matter is submitted to arbitration. Given that Mr. Williams had no specific InterMTA factor numbers to offer, Staff recommends acceptance of Petitioners' InterMTA factor numbers. Staff does not see the age of the study to be a significant problem considering the length of time involved in this arbitration and attendant litigation preliminary to arbitration. The only issue remaining to be resolved in this regard is whether or not to impose a 'net billing' requirement as proposed by Alltel. Staff recommends the inclusion of 'net billing' be in the Agreement. Staff is not persuaded by Petitioners that it would be inappropriate to include 'net billing.' Petitioners offered no sound reason why it should not be granted to Alltel.

### Issue#3

In theory Staff supports the position of the Petitioners that each party be responsible for its own billing and collection functions. Staff is looking for the best combination of accuracy, efficiency and billing dispute minimization. This issue, even more so than the other issues in this arbitration, calls for negotiation and cooperation by and between the parties. Ideally, this cooperation would include a mechanism to share such information as is necessary to accurately compute compensation due within the underlying Agreement. Staff does not anticipate that this type of cooperation is feasible due to the parties' asymmetric positions regarding information availability.

Alltel proposes to use a short-cut 'net factor' billing system that is easier to use, but is less accurate. Petitioners propose that each party obtain the necessary information to do their own billing from actual records. Petitioners' proposal is not a shortcut system, but it is potentially much more accurate. At the heart of the matter is Alltel's claim that it cannot obtain the information and will therefore be barred from billing for IntraMTA traffic. Petitioners believe that it is possible for Alltel to obtain the information. A potentially flawed, short-term study was produced by Alltel that would provide a simple template to handle this 'net factor' billing issue. The study is undoubtedly imperfect, but Staff feels it is better to use it, coupled with Alltel's 'net factor' billing proposal. Staff recommends that Alltel's position with regard to this issue be adopted.

Dated this 10<sup>th</sup> day of October, 2008.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that copies of Staff's Brief were served on the following electronically, at the e-mail addresses shown below on this the 10th day of October, 2008.

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